

# **FINANCIAL AND COMPLIANCE AUDIT REPORT**

**Kansas Lottery  
Fiscal Year 2008**

**A Report to the Legislative Post Audit Committee  
Joint Venture By Allen, Gibbs & Houlik, L.C. and  
Berberich Trahan & Co., P.A., Under Contract with the  
Legislative Division of Post Audit  
State of Kansas  
November 2008**

# ***Legislative Post Audit Committee***

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## ***Legislative Division of Post Audit***

THE LEGISLATIVE POST Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$10 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U.S. Government Accountability Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the Representatives, three are appointed by the Speaker of the House and two are appointed by the Minority Leader.

Audits are performed at the direction of the Legislative Post Audit Committee. Legislators

or committees should make their requests for performance audits through the Chairman or any other member of the Committee. Copies of all completed performance audits are available from the Division's office.

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Senator Nick Jordan  
Senator Les Donovan  
Senator Anthony Hensley  
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Representative Virgil Peck Jr., Vice-Chair  
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Barbara J. Hinton, Legislative Post Auditor

### **DO YOU HAVE AN IDEA FOR IMPROVED GOVERNMENT EFFICIENCY OR COST SAVINGS?**

The Legislative Post Audit Committee and the Legislative Division of Post Audit have launched an initiative to identify ways to help make State government more efficient. If you have an idea to share with us, send it to [ideas@lpa.state.ks.us](mailto:ideas@lpa.state.ks.us), or write to us at the address above.

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LEGISLATURE OF KANSAS

## LEGISLATIVE DIVISION OF POST AUDIT

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November 17, 2008

To: Members, Legislative Post Audit Committee

Senator Derek Schmidt, Chair  
Senator Les Donovan  
Senator Anthony Hensley  
Senator Nick Jordan  
Senator Chris Steineger

Representative Virgil Peck, Jr., Vice-Chair  
Representative Tom Burroughs  
Representative John Grange  
Representative Peggy Mast  
Representative Tom Sawyer

This report contains the findings and conclusions from the completed financial-compliance audit of the Kansas Lottery covering fiscal year 2008. This audit was conducted by a joint venture of Allen Gibbs & Houlik and Berberich Trahan & Co., certified public accounting firms under contract with the Legislative Division of Post Audit. The report recommend that the Lottery take steps to ensure that all year-end accounting adjustments are properly made.

We would be happy to discuss this report with any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton  
Legislative Post Auditor





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## KANSAS LOTTERY

(A COMPONENT UNIT OF THE STATE OF KANSAS)

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FINANCIAL AND COMPLIANCE AUDIT  
YEARS ENDED JUNE 30, 2008 AND 2007

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

FINANCIAL AND COMPLIANCE AUDIT

Years Ended June 30, 2008 and 2007

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**KANSAS LOTTERY**  
(A COMPONENT UNIT OF THE STATE OF KANSAS)  
FINANCIAL AND COMPLIANCE AUDIT  
YEARS ENDED JUNE 30, 2008 AND 2007

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

INTRODUCTION

Year Ended June 30, 2008

The accompanying report represents the results of the financial and compliance audit of the operations of the Kansas Lottery (the Lottery) for the fiscal year ended June 30, 2008.

The Lottery was created as an independent component unit of the State of Kansas to operate lottery games and manage expanded gaming operations. It is administered by the Executive Director and the five members of the Lottery Commission appointed by the Governor. The Lottery is an enterprise fund wherein the activities are financed and operated through user charges similar to a private business enterprise. The Gaming Facility Manager Fund is an agency fund of the Lottery that collects and remits revenues from expanded gaming operations to the State of Kansas.



KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

Year Ended June 30, 2008

A. SUMMARY OF AUDIT RESULTS

1. The auditors' report expresses an unqualified opinion on the financial statements of the Kansas Lottery.
2. No material weaknesses relating to the audit of the financial statements are reported in the report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards*.
3. No instances of noncompliance material to the financial statements of the Kansas Lottery were disclosed during the audit.

B. FINDINGS - FINANCIAL STATEMENT AUDIT

See Schedule of Findings and Responses.

C. PRIOR YEAR FINDINGS

See Prior Year Findings and Responses.

## INDEPENDENT AUDITORS' REPORT

Legislative Post Audit Committee  
Kansas State Legislature:

We have audited the accompanying basic financial statements of the business-type activity and the aggregate remaining fund information of the Kansas Lottery (the Lottery), a component unit of the State of Kansas, as of and for the years ended June 30, 2008 and 2007, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of the Kansas Lottery are intended to present the financial position and the results of its operations and cash flows of the Lottery. They do not purport to, and do not present fairly, the financial position of the State of Kansas as of June 30, 2008 and 2007 and the changes in its financial position and cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activity and the aggregate remaining fund information of the Kansas Lottery, as of June 30, 2008 and 2007, and the results of its operations and cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 13, 2008 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 1 through 9 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Allen, Gibbs & Houlik, L.C.*

*Berberich Trahan & Co., P.A.*

November 13, 2008

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

### **YEARS ENDED JUNE 30, 2008 AND 2007**

The following management's discussion and analysis (MD&A) of the Kansas Lottery's financial performance provides an overview of financial activities for the fiscal years ended June 30, 2008 and 2007. Please read it in conjunction with the Lottery's financial statements, which follow the MD&A. The financial statements reflect only activities of the Kansas Lottery, a component unit of the State of Kansas.

#### **Fiscal Year 2008 Financial Highlights**

- Lottery sales for FY 2008 were \$236,667,471 reflecting a decrease of \$3,287,573 over those in FY 2007, and sales were the second highest since the Lottery began selling tickets in November 1987. The Lottery continued to enjoy another good year of Instant scratch ticket sales in FY 2008. Instant sales were \$115,068,384 compared to \$114,674,052 in FY 2007. By continuing to print considerably more instant games but in smaller quantities, the Lottery was able to offer new games to players on a more frequent basis during FY 2008. This, plus the Lottery's business partnerships with Garmin, Cougar Custom Boats, Kansas Speedway, Wichita River Festival, the 3i Show and the Kansas State Fair in the promotion of special instant scratch games, resulted in a \$394,332 increase compared to FY 2007. Sales of barcoded pull-tab tickets were \$7,593,607 a decrease of \$1,789,143 over FY 2007. Total on-line sales were \$1,892,762 less than the previous year. Three games had increases during FY 2008. Powerball (a Multi-State Lottery (MUSL) game) sales were up \$3,597,012. Kansas Hold'Em, a monitor game, went state-wide, sales increased to \$4,640,878. The Pick 3 game had a slight increase of \$187,823. All other on-line games had decreases during the fiscal year. The Hot Lotto (a MUSL game) had sales of \$9,225,833. Super Kansas Cash sales had a decrease of \$2,624,283 over the FY 2007 figures. Keno resulted in a decrease of \$2,369,404. The 2by2 game realized sales of \$1,652,834 which was a decrease of \$65,111 from the previous year. The eScratch game was discontinued on January 1, 2008, and the six month's sales were \$1,048,865.
- For 2008 the legislature again waived the requirement of monthly transfers to the State Gaming Revenues Fund (SGRF) being based on an amount of approximately 30% of sales. Instead, it originally set a minimum amount of \$73,000,000 with no less than \$4,500,000 being transferred in any one month. As a result, the regular transfers to the SGRF were \$70,000,000. The SGRF transferred to the State General Fund (SGF) the special veterans' games amount of \$880,163. And lastly, Accounts and Reports transferred a total of \$46,954 to the SGF for various administrative costs charged to the Lottery and mandatory budget reductions. The final amount transferred to both the SGRF and the SGF was \$70,046,954, which reflects a \$969,144 total decrease from the previous year. Transfers to the SGRF are capped at \$50 million. Overages become part of the State General Fund. Of the \$50 million, the first \$80,000 is earmarked for the Problem Gambling Grant Fund (PGGF), then 85% of the balance goes to the Economic Development Initiatives Fund (EDIF), 10% to prison reconstruction, and 5% to juvenile detention facilities.

- Operating income as a percent of total operating revenues was 28.2% which is 1% less than FY 2007. Sales were 1.37% less than FY 2007 with the operating income remaining stable at approximately the 30% level.

### **Using this Financial Report**

This report consists of a series of financial statements and reflects the self-supporting activities of the Kansas Lottery. The Balance Sheets provide information about the Lottery's assets and liabilities and reflect the Lottery's financial position as of June 30, 2008 and 2007. The Statements of Revenues, Expenses and Changes in Net Assets report the activity of selling lottery tickets and the related expenses for the 12-month periods ended June 30, 2008 and 2007. And lastly, the Statements of Cash Flows reflect the cash inflows and outflows attributed to the sales of lottery tickets for the same 12-month periods.

### **Game Revenues**

Revenues from the sale of lottery tickets for the fiscal year ended June 30, 2008 were the second highest year since the Lottery's first sales began in November 1987. They were -1.37% or \$3,287,573 less than the previous year, as indicated in the financial statements. FY 2008 sales were \$236,667,471 compared to \$239,955,044 in FY 2007. The decrease in sales was made up of (1) Super Kansas Cash had a \$2,624,283 decrease in sales compared to the prior year; (2) Hot Lotto decreased in sales by \$2,235,589 compared to the prior year; and (3) Keno's sales decreased by \$2,369,404 from the prior year. Several games had increased sales. The instant scratch sales were \$394,332 greater than those in FY 2007. The Lottery is continuing to keeping fresh games available to the public and partnering with Kansas Speedway, 3i Show, Wichita River Festival, Kansas State Fair, and other businesses in special games promotions. Powerball had an increase in sales of \$3,597,012 over FY 2007. Kansas Hold'Em went state-wide and had sales of \$4,640,878. A new multi-state instant scratch game was introduced with the state of Iowa called Mid-West Millions. Each state received the same number of tickets for sale, and with two drawings being held, one in each state for a top prize of \$500,000 at each drawing. The eScratch game was discontinued January 1, 2008, with the partial year sales of \$1,048,865.

Presented in millions of dollars, the following table compares Lottery sales by game type between fiscal years:

<u>Type of Game</u>	<u>2008</u>	<u>2007</u>	<u>Difference</u>	<u>Percentage</u>
Instant	\$ 115.1	\$ 114.7	\$ 0.4	0.4%
Pull-Tabs	7.6	9.4	(1.8)	-19.1%
Powerball	43.0	39.4	3.6	9.2%
2by2	1.6	1.7	(0.1)	-3.6%
Super Kansas Cash	17.4	20.0	(2.6)	-13.1%
Keno	31.3	33.6	(2.3)	-7.0%
Pick 3	5.8	5.6	0.2	3.3%
eScratch	1.0	2.4	(1.4)	-55.7%
Hot Lotto	9.2	11.5	(2.3)	-19.5%
Kansas Hold'Em	4.6	1.7	2.9	172.6%
Total	<u>\$ 236.6</u>	<u>\$ 240.0</u>	<u>\$ (3.4)</u>	<u>-1.36%</u>

Revenues from the sale of lottery tickets for the fiscal year ended June 30, 2007, were the highest year since the Lottery's first sales began in November 1987. They were 1.7% or \$3,909,099 greater than the previous year, as indicated in the financial statements. FY 2007 sales were \$239,955,044 compared to \$236,045,945 in FY 2006. The increase in sales was made up of (1) Instant ticket sales increase of \$7,308,479, (2) Pulltab sales increase of \$2,346,096, (3) Super Kansas Cash increase of \$876,176, and (4) Hot Lotto full year of sales at \$11,461,422. The increase in sales was accomplished by keeping fresh games available to the public and partnering with Cabela's, Kansas Speedway, Kansas State Fair, the 3i Show and other businesses, in special games promotions. Kansas Hold'Em was added as a on-line monitor game in September 2006 as a test market with 100 retailers, and had sales of \$1,702,686.

Presented in millions of dollars, the following table compares Lottery sales by game type between fiscal years:

<u>Type of Game</u>	<u>2007</u>	<u>2006</u>	<u>Difference</u>	<u>Percentage</u>
Instant	\$ 114.7	\$ 107.3	\$ 7.4	6.9%
Pull-Tabs	9.4	7.0	2.4	34.3%
Powerball	39.4	54.4	(15.0)	-27.6%
2by2	1.7	1.9	(0.2)	-10.5%
Super Kansas Cash	20.0	19.2	0.8	4.2%
Keno	33.6	36.3	(2.7)	-7.4%
Pick 3	5.6	5.5	0.1	1.8%
eScratch	2.4	1.9	0.5	26.3%
Hot Lotto	11.5	2.5	9.0	360.0%
Kansas Hold'Em	1.7	-	1.7	0.0%
Total	<u>\$ 240.0</u>	<u>\$ 236.0</u>	<u>\$ 4.0</u>	<u>1.7%</u>

## Total Revenues

Other operating revenues consist of \$150 per retailer application fees and a \$10 per week per retailer lottery terminal satellite communication reimbursement charge. For the fiscal year ended June 30, 2008 these revenues amounted to \$988,870 compared to \$1,072,600 for FY 2007, and \$1,224,536 for FY 2006.

Total revenues for FY 2008 were \$238,348,858 in comparison to \$241,441,061 for FY 2007, a decrease of \$3,092,203 or 1.28% less. The decrease in revenue was the result of the sales decreases on the on-line Super Kansas Cash, Keno, and the Pull-Tab games.

Total revenues for FY 2007 were \$241,441,061 in comparison to \$237,270,481 for FY 2006, an increase of \$4,170,580 or 1.7%. The increase in revenues was the result of the sales increases of the Instant and Pull-Tab games.

## Major Expenses

Approximately \$158.9 million of the Lottery's total operating expenses of \$171.2 million for FY 2008 were directly associated with lottery games. For FY 2007, the game-related expenses were \$160.4 million of a total \$171.0 million. These expenses include game prizes, retailer commissions, on-line game service bureau fees, telecommunications costs for on-line terminal satellite connections to retailer locations, and the cost of printing instant tickets. The satellite communication system provides telecommunications for approximately 1,800 retailers' terminals. This system continued to perform well throughout FY 2008 and has eliminated communication downtime from various causes such as storms, cables cut as a result of construction or street repair projects, etc.

The following table compares the game-related expenses between FY 2008 and FY 2007. The expenses are shown in millions of dollars:

<u>Description</u>	<u>2008</u>	<u>2007</u>	<u>Difference</u>	<u>Percentage</u>
Game Prizes	\$ 133.0	\$ 134.2	\$ (1.2)	-0.9%
Retailer Commissions	13.8	13.9	(0.1)	-0.7%
On-line Games Service Bureau	5.6	6.1	(0.5)	-8.2%
Telecommunications Terminal Costs	2.0	2.0	-	0.0%
Instant Ticket Printing Costs	4.5	4.2	0.3	7.1%
Total	<u>\$ 158.9</u>	<u>\$ 160.4</u>	<u>\$ (1.5)</u>	<u>-0.9%</u>

The overall decrease in Game Prizes was the result of the decrease in sales compared to those in FY 2007. The Telecommunications Terminal Costs remained the same. The On-line Games Service Bureau costs decreased as a result of the less on-line sales. Instant Ticket Printing Costs for FY 2008 increased as sales increased by .36%, and the strategy of ordering smaller quantities of each game was successful.

Of the \$12.3 million of FY 2008 operating expenses that were not game-related, \$5.6 million was for employees' salaries and wages, \$3.1 million was spent for games and promotional advertising, and other administrative expenses accounted for \$3.6 million. In FY 2007, these same expenses were \$4.4 million, \$3.3 million and \$2.8 million, respectively. The Lottery continued the successful promotions with the business partnerships including Kansas Speedway, 3i Show, Kansas State Fair and other businesses in Kansas. Many of the promotions were second chance drawing giveaways that included products made in Kansas and a number of vehicle and boat giveaways.

The following table compares the game-related expenses between FY 2007 and FY 2006. The expenses are shown in millions of dollars:

<u>Description</u>	<u>2007</u>	<u>2006</u>	<u>Difference</u>	<u>Percentage</u>
Game Prizes	\$ 134.2	\$ 131.0	\$ 3.2	2.4%
Retailer Commissions	13.9	13.6	0.3	2.2%
On-line Games Service Bureau	6.1	6.3	(0.2)	-3.2%
Telecommunications Terminal Costs	2.0	2.1	(0.1)	-4.8%
Instant Ticket Printing Costs	4.2	4.6	(0.4)	-8.7%
Total	<u>\$ 160.4</u>	<u>\$ 157.6</u>	<u>\$ 2.8</u>	<u>1.8%</u>

The overall increase in Game Prizes was the result of the increase in sales compared to those in FY 2006. The Telecommunications Terminal Costs has remained the same. The On-line Games Service Bureau costs decreased as a result of fewer on-line sales.

Of the \$10.5 million of FY 2007 operating expenses that were not game-related, \$4.4 million was for employees' salaries and wages, \$3.3 million was spent for games and promotional advertising, and other administrative expenses accounted for \$2.8 million. In FY 2006, these same expenses were \$4.3 million, \$2.8 million and \$2.9 million, respectively. The Lottery engaged in slightly more promotional advertising for fiscal year 2007 and continued the successful promotions with the business partnerships including Cabela's, Kansas Speedway, Midwest Ford, Saturn, Kansas State Fair and other businesses in Kansas. Many of the promotions were second chance drawing giveaways that included products made in Kansas and a number of vehicle giveaways.

Approximately \$157.6 million of the Lottery's total operating expenses of \$167.6 million for FY 2006 were directly associated with lottery games. For FY 2005, the game-related expenses were \$136.1 million of a total \$145.5 million. These expenses include game prizes, retailer commissions, on-line game service bureau fees, telecommunications costs for on-line terminal satellite connections to retailer locations, and the cost of printing instant tickets. The satellite communication system provides telecommunications for approximately 1,900 retailers' terminals.

## Other Financial Information

The following table presents the Lottery's assets, liabilities, and net assets (shown in millions of dollars):

	2008	2007	2006
Current and other assets	17.1	\$ 19.9	\$ 19.6
Capital assets	0.4	0.3	0.3
Total assets	17.5	20.2	19.9
Current liabilities	13.3	13.1	12.3
Net assets			
Invested in capital assets	0.4	0.2	0.3
Unrestricted	3.8	6.9	7.3
Total net assets	\$ 4.2	\$ 7.1	\$ 7.6

At June 30, 2008 were \$17.5 million in total assets consisting of \$5.7 million in cash for operations and prizes, \$8.8 million in accounts receivable from retailers, a MUSL restricted accounts receivable of \$.9 million, \$1.7 million in instant ticket inventory, and \$0.4 million in net property and equipment.

At June 30, 2007, the Lottery had \$20.2 million in total assets consisting of \$8.9 million in cash for operations and prizes, \$8.2 million in accounts receivable from retailers, \$1.1 in other receivables, \$1.7 million in instant ticket inventory, and \$0.3 million in net property and equipment.

Comparable figures for total assets of the Lottery for the fiscal year ended June 30, 2006, were \$19.9 million. They consisted of cash for operations and prizes of \$10.0 million, accounts receivable from Lottery retailers for lottery tickets sales activity of \$7.2 million, a MUSL restricted accounts receivable of \$.7 million, instant ticket inventory totaling \$1.7 million, and property and equipment net of depreciation amounting to \$0.3 million.

At June 30, 2008, total liabilities were \$13.3 million, of which, \$2.4 million was in accounts payable and accrued liabilities, \$6.0 million was due to the State of Kansas, and \$4.9 million was for prize liability.

At June 30, 2007, total liabilities were \$13.1, of which \$1.5 million was in accounts payable and accrued liabilities, \$5.8 million was due to the State of Kansas, and \$5.8 million was for prize liability.

Total liabilities of the Lottery at June 30, 2006 were \$12.3 million and were comprised of accounts payable and accrued liabilities of \$1.2 million, transfers due to the State of Kansas of \$5.8 million, and prize liability of \$5.3 million.

The change in net assets between FY 2008 and FY 2007 was a decrease of \$2.9 million. The results of the overall decrease in sales revenues of \$3.3 million, unrestricted net assets decreased by \$3.1 million.

The change in net assets between FY 2007 and FY 2006 had a decrease of \$0.5 million, unrestricted net assets decreased by \$0.4 million.



## **Transfers to the State Gaming Revenues Fund (SGRF) and State General Fund (SGF)**

For FY 2008 the legislature waived the percentage of sales SGRF requirement for a minimum transfer of \$73,000,000 originally with a minimum monthly transfer of \$4,500,000. Final regular transfers to the SGRF were \$70,000,000. The special veterans' games contributed \$880,163 of the transfer. Accounts and Reports transferred \$46,954 to the State General Fund. The final amounts transferred to both the SGRF and the SGF was \$70,046,954, which reflects a \$969,144 decrease from FY 2007.

For FY 2007 the legislature again waived the percentage of sales SGRF requirement for a minimum transfer of \$66,288,000 originally with a minimum monthly transfer of \$4,500,000. Final regular transfers to the SGRF were \$70,086,862. The special veterans' games contributed another \$913,138. Accounts and Reports transferred \$16,098 to the State General Fund. The final amounts transferred to both the SGRF and the SGF was \$71,016,098, which reflects a \$3,927,489 increase from FY 2006.

For FY 2006 the legislature again waived the percentage of sales SGRF requirement for a minimum transfer of \$66,000,000 originally with a minimum monthly transfer of \$4,500,000. Final regular transfers to the SGRF were \$66,288,000. The special veterans' games contributed another \$717,113. Accounts and Reports transferred \$83,496 to the State General Fund. The final amounts transferred to both the SGRF and the SGF was \$67,088,609, which reflects a \$1,679,168 increase from FY 2005.

Although most Lottery transfers are made to the SGRF, there is a \$50 million cap of that fund; therefore, any transfers in excess of \$50 million are subsequently transferred to the State General Fund (SGF). Of the \$50 million in the SGRF, the first \$80,000 is transferred to the Problem Gambling Grant Fund (PGGF). Then, of the balance remaining, 85% is transferred to the Economic Development Initiatives Fund (EDIF), 10% to the Correctional Institutions Building Fund (CIBF), and 5% to the Juvenile Detention Facilities Fund (JDFF). It should be noted that the Lottery has no control over or involvement in the transfers going out of the SGRF.

## **Budgetary Process and Highlights**

The Lottery is a component unit of the State of Kansas, and is a fully self-supporting entity and receives no monies from the State General Fund. The Lottery is required to annually submit by September 15<sup>th</sup> its budget to the Division of the Budget (DOB). The budget is prepared on a cash basis that revamps the current year based on expenditure limitations approved by the legislature during the previous legislative session, and submits a proposed budget for the next year that is considered the budget year. For example, after receiving the required approval of the Kansas Lottery Commission, on September 15, 2008, the budget submitted consisted of the revision for the fiscal year ending June 30, 2009 and a first-time submission for the fiscal year ending June 30, 2010.

The Lottery has in the past operated with both limited and unlimited expenditures, however the 2005 Legislature removed the limit on all types of expenditures. Administrative type expenditures are payroll, rents, utilities, travel, audit services, various types of office and professional supplies, capital outlay, etc., and does include advertising expense. Other unlimited expenditures consist of sales driven expenses or cost of sales expenses such as telecommunication costs for satellite connections to the lottery terminals in retailer locations, instant scratch ticket printing costs, fees paid to the on-line vendor, and auto-ship freight and supplies.

In November of each year, the Division of the Budget (DOB) returns to the Lottery the DOB's recommendations that usually include some changes. The Lottery may appeal to the DOB and the Governor if it deems necessary. The final DOB recommendations are sent to the Governor for his/her submission to the newly convened legislature in January. The budget then goes through a lengthy legislative process and may have changed by the time it is finally approved in April.

For FY 2008, the approved no-limit cost of sales budget was \$14,570,919 and the final unlimited administration budget amount was \$11,730,561. On a cash basis, actual expenses were \$11,831,068 and \$10,267,394, respectively.

### **Fiscal Year 2009 Budget**

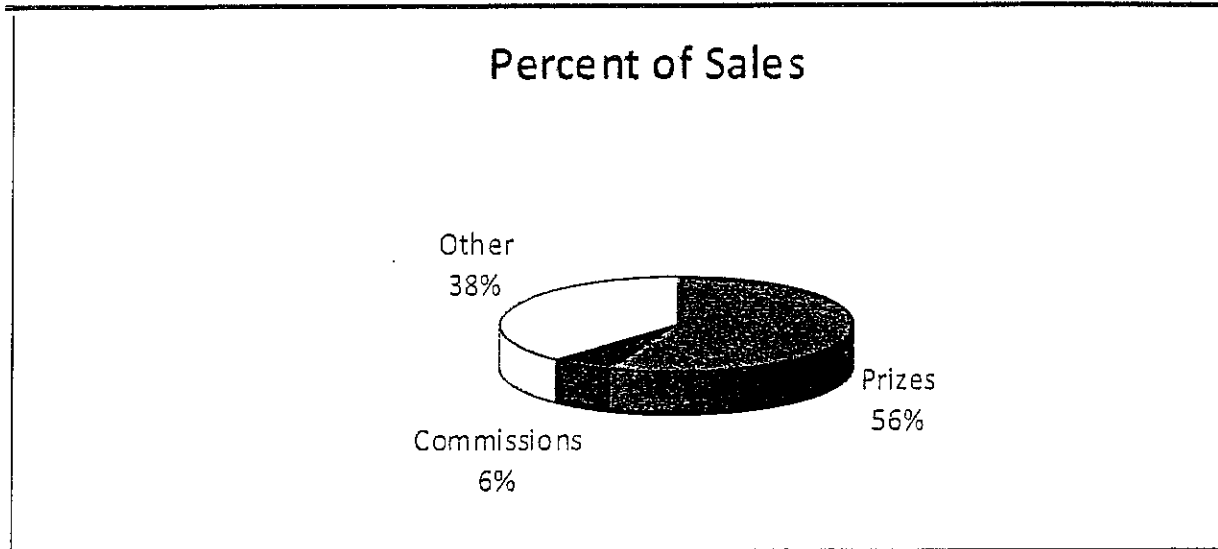
For FY 2009, the 2008 legislature has, once again, waived the previously required transfer rate based on a percentage of ticket sales in favor of a set minimum amount. This decision will afford the Lottery additional operating flexibility, and should result in increased ticket sales, with an estimated \$11 million more than those in FY 2008. The sales for FY 2009 are being projected at a greater amount than the FY 2008 results because of the continued smaller games and higher priced games. Also the auto-ship program is getting the games out to the retailers on a timely basis by monitoring the retailers' ticket inventories and automatically replacing instant ticket stock as needed. Continuing the partnerships and sponsorships with Kansas based businesses has enhanced second chance drawings. The Powerball on-line game will be enhanced effective January 2009, and is designed to increase jackpots with a greater number of low tier prizes, thus increasing sales. The legislature has approved the Lottery to transfer to the SGRF a minimum of \$74,000,000 including the net proceeds of the instant scratch games designated to benefit veterans' causes. Legislation changes the veteran's games for sales to be year round. The revised FY 2009 budget has decreased the transfer amount to the SGRF to \$72 million. Overall, the Lottery has set a revised sales goal of \$248.0 million for FY 2009. Administrative expenses for FY 2009 have been revised in the budget to \$11.2 million from the approved amount of \$11.5. Payroll consists of \$5.2 million, the Lottery is required to budget for payroll as if all positions were filled, and all approved pay increases are included. The contractual services of \$4.6 million are a major part of the Administrative budget, and commodities have a budgeted amount of \$.7 million. Capital outlay has a budget of \$.7 million which includes the cost for replacing seven high mileage vehicles. The 2007 Legislature passed SB66 enacting the Expanded Lottery Act. The FY 2009 operating budget in the amount of \$583,284 has been submitted to cover implementation cost. SB 66 provides for applicants and Facilities Management to reimburse the Lottery for the business expenses.

### **Contacting the Lottery's Financial Management**

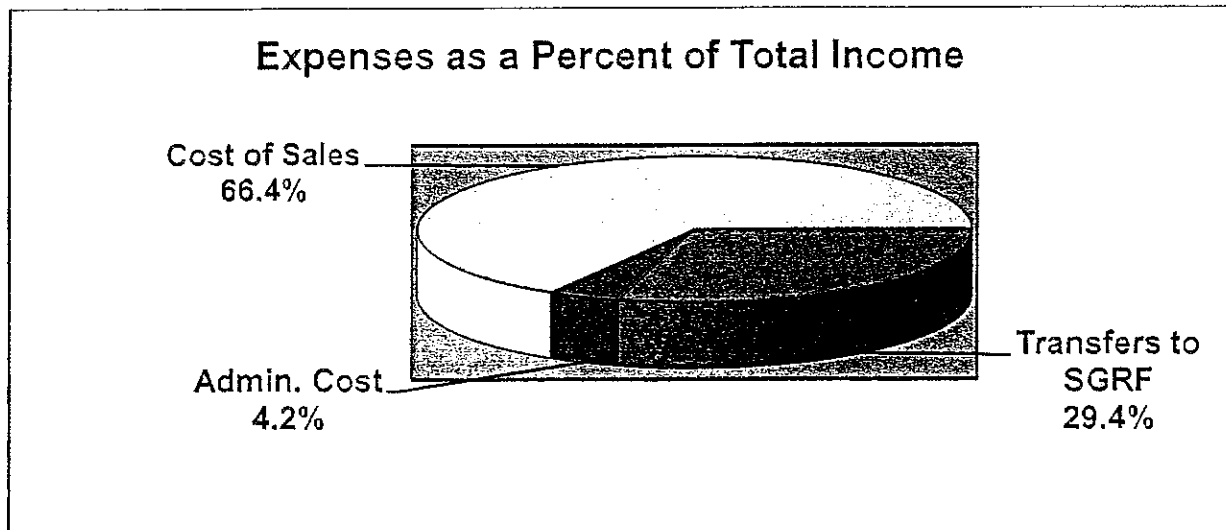
This management's discussion and analysis report is designed to provide Kansas citizens, Kansas government officials, players, retailers and other interested parties with a general overview of the Lottery's financial activity for the fiscal years ended June 30, 2008 and 2007 and to demonstrate the Lottery's accountability for the monies it received from its lottery ticket sales activity. Questions or comments about this report may be addressed to Carolyn Brock, Director of Finance or Wayne Regnier, Fiscal Manager at 128 N. Kansas Avenue, Topeka, KS 66603.

See graphs of financial highlights on the following page.

KANSAS LOTTERY  
GRAPHS OF FINANCIAL HIGHLIGHTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2008



To depict compliance with the 45% prize payment statute and the retailers' commissions rules.



To depict expenditures as a percentage of total income.

The Cost of Sales category includes prizes, commissions, service bureau, terminal phone/satellite lines, auto-ship, and instant ticket printing.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)  
PROPRIETARY FUND  
BALANCE SHEETS

June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
<u>ASSETS</u>		
Current assets:		
Cash:		
Operating fund	\$ 4,915,281	\$ 7,704,863
Prize payment fund	783,909	1,212,112
Accounts receivable, net of allowance for doubtful accounts of \$ 513,819 and \$ 503,536 at 2008 and 2007, respectively	3,138,024	2,429,319
Accounts receivable - unbilled	5,686,942	5,745,519
Other receivable	901,198	1,091,961
Instant ticket game inventory	1,720,938	1,750,372
Total current assets	<u>17,146,292</u>	<u>19,934,146</u>
Capital assets:		
Property and equipment	4,418,127	4,258,024
Less accumulated depreciation	<u>4,057,744</u>	<u>4,007,005</u>
Total capital assets	<u>360,383</u>	<u>251,019</u>
Total assets	<u>\$ 17,506,675</u>	<u>\$ 20,185,165</u>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 2,345,147	\$ 1,525,235
Due to State Gaming Revenue fund	6,000,000	5,750,000
Prize liability	<u>4,933,775</u>	<u>5,780,863</u>
Total current liabilities	<u>13,278,922</u>	<u>13,056,098</u>
Net assets:		
Invested in capital assets	360,383	251,019
Unrestricted	<u>3,867,370</u>	<u>6,878,048</u>
Total net assets	<u>4,227,753</u>	<u>7,129,067</u>
Total liabilities and net assets	<u>\$ 17,506,675</u>	<u>\$ 20,185,165</u>

See accompanying notes to financial statements.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)  
PROPRIETARY FUND  
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Operating revenues:		
Net game revenues	\$ 230,681,216	\$ 233,907,129
Net unsettled revenues	5,986,255	6,047,915
Retailer fees and miscellaneous income	55,907	490,453
Expanded gaming reimbursements	676,810	-
Phone reimbursements	948,670	995,564
	<u>238,348,858</u>	<u>241,441,061</u>
Total operating revenues		
Operating expenses:		
Game prizes	132,970,457	134,207,490
Retailer commissions	13,768,683	13,936,849
Advertising	3,117,249	3,347,660
Cost of instant tickets	4,469,756	4,196,763
Depreciation	133,945	140,965
Professional services	510,943	182,393
On-line games service bureau	5,632,200	6,053,731
Salaries and benefits	5,604,196	4,425,111
Telecommunications	2,015,876	2,052,085
Other administrative expense	2,992,473	2,384,646
	<u>171,215,778</u>	<u>170,927,693</u>
Total operating expenses		
Operating income	<u>67,133,080</u>	<u>70,513,368</u>
Nonoperating revenues (expenses):		
Payments to State of Kansas	(70,046,954)	(71,016,098)
Gain on sale of capital assets	12,560	12,623
	<u>(70,034,394)</u>	<u>(71,003,475)</u>
Total nonoperating revenues (expenses)		
Change in net assets	(2,901,314)	(490,107)
Net assets, beginning of year	<u>7,129,067</u>	<u>7,619,174</u>
Net assets, end of year	<u>\$ 4,227,753</u>	<u>\$ 7,129,067</u>

See accompanying notes to financial statements.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)  
PROPRIETARY FUND  
STATEMENTS OF CASH FLOWS

Years Ended June 30, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 237,889,493	\$ 240,111,098
Cash paid for prizes, commissions, and other expenses	(166,264,747)	(165,632,438)
Cash paid to employees	(4,814,828)	(4,403,189)
Net cash provided by operating activities	<u>66,809,918</u>	<u>70,075,471</u>
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue fund	(69,750,000)	(71,005,113)
Payments to State General fund	(46,954)	(16,098)
Net cash used by noncapital financing activities	<u>(69,796,954)</u>	<u>(71,021,211)</u>
Cash flows from capital and related financing activities:		
Proceeds from sale of capital assets	12,560	15,128
Purchase of capital assets	(243,309)	(114,642)
Net cash used by capital and related financing activities	<u>(230,749)</u>	<u>(99,514)</u>
Net decrease in cash	(3,217,785)	(1,045,254)
Cash, beginning of year	8,916,975	9,962,229
Cash, end of year	<u>\$ 5,699,190</u>	<u>\$ 8,916,975</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 67,133,080	\$ 70,513,368
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	133,945	140,965
Changes in operating assets and liabilities:		
Accounts receivable	(650,128)	(909,462)
Other receivable	190,763	(420,501)
Instant ticket game inventory	29,434	(69,457)
Accounts payable and accrued liabilities	819,912	285,911
Prize liability	(847,088)	534,647
Net cash provided by operating activities	<u>\$ 66,809,918</u>	<u>\$ 70,075,471</u>

See accompanying notes to financial statements.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

STATEMENT OF FIDUCIARY NET ASSETS - AGENCY FUND

June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Assets:		
Cash	<u>\$ 236,000,000</u>	<u>\$ -</u>
Liabilities:		
Due to the State of Kansas	<u>\$ 236,000,000</u>	<u>\$ -</u>

See accompanying notes to financial statements.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)  
NOTES TO FINANCIAL STATEMENTS

June 30, 2008 and 2007

1 - Summary of Significant Accounting Policies

Reporting Entity

In November 1986, a constitutional amendment was approved by the Kansas voters authorizing a State Lottery. During the 1987 Legislative session, the State Legislature adopted the Lottery Act (the Act), and created the Kansas Lottery (the Lottery) as an independent component unit of the State of Kansas to operate lottery games. The 2007 Legislative session continued the Lottery until July 1, 2022. The Kansas Lottery Act abolishes the Lottery on July 1, 2022 unless the Legislature reaches an affirmative vote to continue the Lottery.

The Lottery was organized on March 19, 1987 and commenced administrative operations on May 21, 1987 but was strictly in the developmental stage through fiscal year 1987. Instant win ticket games began November 12, 1987. On February 2, 1988, the Lottery began participating in Lotto America, a multi-state on-line game now called Powerball. Additional games offered by the Lottery include Kansas Cash, Keno, Pick 3, 2 by 2, Hot Lotto, Kansas Hold 'Em, and Pull Tabs. The eScratch game was discontinued on January 1, 2008.

The 2007 Legislature passed Senate Bill 66, the Expanded Lottery Act. The Act provides for the Kansas Lottery to own and operate electronic gaming machines at the three existing Kansas horse and dog racetracks, upon the county's voter approval. The Act also allows for the Lottery, upon county voter approval, to own and operate four casinos in specific gaming zones.

The Lottery operates under the direction of the Executive Director of the Lottery and a five-member Lottery Commission appointed by the Governor. The Commission advises the Executive Director and reviews and approves Lottery games, rules, and regulations.

Basis of Presentation

The Lottery is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises where the intent is that the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges or where the periodic determination of net income is considered appropriate. Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed by the Lottery to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Lottery has elected not to follow subsequent private-sector guidance. The Gaming Facility Manager Fund is accounted for as an agency fund as it accounts for assets temporarily held by the Lottery for the State of Kansas.



KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

1 - Summary of Significant Accounting Policies (Continued)

Basis of Accounting

The financial statements of the Lottery have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Basis of accounting refers to when revenues, expenses and the related assets and liabilities are recognized in the accounts and reported in the financial statements. Measurement focus refers to what is being measured. The financial statements of the proprietary funds are prepared on the accrual basis of accounting and on an economic resources measurement focus in accordance with GAAP.

The Lottery distinguishes operating revenue and expenses from nonoperating items. The principal revenue of the Lottery is primarily comprised of sales from instant and on-line tickets. Operating expenses mainly consist of payments to prize winners, commissions to retailer agents and payments to vendors and employees.

The agency funds do not have a measurement focus, but use the accrual basis of accounting.

Revenue Recognition

Lottery games are sold to the public by contracted retailers. The Lottery utilizes an on-line instant ticket validation system. This system utilizes a bar code system to activate, track and validate instant win tickets which are consigned to retailers. The activated and unsettled instant win ticket packets are reflected in revenues in the current period and are carried on the balance sheet as accounts receivable - unbilled. Consigned instant win and pull tab ticket packets at the retailer that have not been activated are reflected on the financial statements in ticket inventory at original cost.

Certain instant ticket games include tickets which entitle the holder to exchange the ticket for another ticket ("free tickets"). Such tickets are deemed to be replacements and, therefore, are not included in sales. On-line game revenue is recognized in the period in which tickets are sold.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

1 - Summary of Significant Accounting Policies (Continued)

Retailer Commissions

Retailers receive a commission of five percent of ticket sales, which is recognized as expense when sales are recorded. In addition to the five percent commission on sales, retailers receive a one percent cashing bonus for redeeming prizes that are less than \$ 600, an additional one percent for redeeming Keno prizes and a bonus of one percent on instant and on-line tickets they sell that win over \$ 600, with a minimum of \$ 10 and a maximum of \$ 100 for each prize.

Retailers also receive a bonus of \$ 10,000 for selling a winning Powerball jackpot ticket, a \$ 2,500 bonus for selling a winning Hot Lotto jackpot ticket, and a \$ 1,000 bonus for selling a winning Kansas Cash jackpot ticket or a winning \$ 100,000 or greater Powerball ticket.

Retailer Fees

Licensed retailers are charged a one-time fee for the right to sell lottery tickets. Fees are recorded as income when received by the Lottery.

Expanded Gaming Reimbursements

According to Senate Bill 66, each potential management company in each of the expanded gaming districts is to reimburse the Lottery for expenses incurred related to its management of the expanded gaming initiative. The Lottery recognizes these revenues as the related expenses are incurred.

Accounts Receivable

Accounts receivable represent amounts to be collected from retailers and are shown net of an allowance for doubtful accounts. The allowance for doubtful accounts is based on an analysis of accounts receivable, which considers the age of the accounts and current economic conditions. Generally accounts greater than 60 days old are included in the allowance for doubtful accounts.

Ticket Inventory

Instant ticket game inventory consists of tickets stored in the main and regional warehouses and consigned and inactivated tickets at the retailer. Inventories are carried at cost based on the specific identification method. Tickets are charged to expense when activated by a licensed retailer. Unsold tickets are charged to expense at the end of each instant ticket game.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

1 - Summary of Significant Accounting Policies (Continued)

Capital Assets

Capital assets, which include property and equipment, are defined by the State of Kansas as assets with an initial, individual cost of more than \$ 5,000. Such assets are recorded at historical cost. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized. Depreciation is computed on the straight-line basis using estimated useful lives of three to five years.

Prize Liability

The Act states "as nearly as practical, an amount equal to not less than 45 percent of the total sales of lottery tickets or shares, computed on an annual basis, shall be allocated for payment of Lottery prizes." This amount is recognized and accrued as a prize liability. Actual prizes paid are treated as a reduction of the prize liability.

Prize expense for instant ticket games is recorded based on the predetermined prize structure for each game. Since instant prize tickets are randomly distributed throughout the tickets, there will be differences between amounts accrued and the amounts actually paid if all tickets for a game have not yet been sold.

Prizes which are not claimed within 180 days after the termination of each game are removed from the prize pool, and future prizes will be increased accordingly through special prize promotions.

Prize expense for on-line games is recorded based on ticket sales. Prizes which are not claimed within one year after the drawing remain in the prize pool, and future prizes will be increased accordingly through special prize promotions.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

1 - Summary of Significant Accounting Policies (Continued)

Compensated Absences

Under the terms of the Lottery's personnel policy, employees are granted vacation and sick leave in varying amounts based upon length of service. In the event of termination or separation, an employee is generally paid for accumulated vacation up to 144 hours for service less than five years; 176 hours for service between five and ten years; 208 hours for service between ten and fifteen years; and 240 hours if service exceeds fifteen years [K.A.R. 1-9-4]. Accordingly, it is the Lottery's policy to record vacation pay as an expense as it is earned. The amount of earned but unused accumulated vacation is included as an accrued liability in the accompanying financial statements.

Retiring employees are paid a portion of their accumulated sick leave in excess of 100 or more days, depending upon the total number of accumulated days and years of service. The minimum payable is 30 days, and the maximum is limited to 60 days. The amount of earned but unused accumulated sick leave is paid from the State Leave Payment Reserve fund to which the Lottery makes monthly contributions.

Budget

The Lottery prepares an annual budget of expenses which is approved by the State Legislature of Kansas. Any changes in the budget must also be approved by the State Legislature. Such budgets are adopted on a cash plus encumbrance basis, which differs from accounting principles generally accepted in the United States of America. Encumbrances represent commitments relating to unperformed contracts for goods or services. All budgeted, unencumbered funds lapse at fiscal year-end.

Statement of Cash Flows

For purposes of the statement of cash flows, cash includes cash on hand and in banks and amounts deposited with the Treasurer of the State of Kansas.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

1 - Summary of Significant Accounting Policies (Continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Pending Governmental Accounting Standards Board Statements

At June 30, 2008, the Governmental Accounting Standards Board (GASB) had issued a statement not yet implemented by the Lottery. The statement that might impact the Lottery is as follows:

GASB Statement No. 51, "*Accounting and Financial Reporting for Intangible Assets*", was issued in June 2004. This statement establishes standards for when and whether intangible assets should be considered capital assets for financial reporting purposes. It requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This statement also provides authoritative guidance that specifically addresses the nature of these assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets. The provisions of this statement are effective for periods beginning after June 15, 2009.

2 - Cash

Cash, other than petty cash and imprest funds, is part of the common cash pool in the State Treasury. The Pooled Money Investment Board invests funds of the common cash pool in excess of that necessary to meet current obligations. Collateral is required for deposits made by the common cash pool that are not covered by federal deposit insurance. The fair value of the collateral must equal 100 percent of the uninsured deposit and is held by the State Treasurer or an independent third party in the State Treasurer's name. At least monthly, the State Treasurer determines that the fair value of the collateral is adequate. Earnings on investments are retained by the State of Kansas. At June 30, 2008 and 2007, the Lottery's share in the State's common cash pool was \$ 5,584,552 and \$ 8,823,395 respectively. The agency fund's share in the State's common cash pool was \$ 236,000,000 at June 30, 2008.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

3 - Capital Assets

Property and equipment consisted of the following for the years ended June 30, 2008 and 2007:

Fiscal Year 2008:	Beginning Balance	Increases	Decreases	Ending Balance
Data processing equipment	\$ 2,755,348	\$ 50,656	\$ -	\$ 2,806,004
Office furniture, fixtures, and equipment	812,420	25	-	812,445
Vehicles and other	690,256	192,628	(83,206)	799,678
	<u>\$ 4,258,024</u>	<u>\$ 243,309</u>	<u>\$ (83,206)</u>	<u>\$ 4,418,127</u>
Accumulated depreciation	<u>\$(4,007,005)</u>	<u>\$ (133,945)</u>	<u>\$ 83,206</u>	<u>\$(4,057,744)</u>
Fiscal Year 2007:	Beginning Balance	Increases	Decreases	Ending Balance
Data processing equipment	\$ 2,751,078	\$ 4,270	\$ -	\$ 2,755,348
Office furniture, fixtures, and equipment	812,420	-	-	812,420
Vehicles and other	639,411	110,372	(59,527)	690,256
	<u>\$ 4,202,909</u>	<u>\$ 114,642</u>	<u>\$ (59,527)</u>	<u>\$ 4,258,024</u>
Accumulated depreciation	<u>\$(3,923,062)</u>	<u>\$ (140,965)</u>	<u>\$ 57,022</u>	<u>\$(4,007,005)</u>

4 - Commitments

The Lottery leases office and warehouse space in both Topeka and Great Bend under operating leases from unrelated parties. Minimum future lease payments by fiscal year are as follows:

2009	\$ 508,084
2010	64,655
2011	64,655
2012	64,655
2013	52,303
2014-2018	32,200
	<u>\$ 786,552</u>

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

4 - Commitments (Continued)

It is anticipated that as leases expire they will be replaced with new leases.

The Lottery incurred office, warehouse and miscellaneous rental expense of approximately \$ 450,285 and \$ 442,335 under operating leases for the years ended June 30, 2008 and 2007, respectively.

The Lottery has contracted with a service bureau which provides computer services for on-line games and instant-win validation. The duration of the current contract is through June 30, 2018. Future fees, calculated on cumulative net on-line sales (gross, less cancels, coupons, free tickets and rejected tickets) through June 30, 2008 are 5.12 percent, with no fee for validation of instant win games. Effective July 1, 2008, fees are 4.9999 percent, with no fee for validation of instant win games.

5 - Contingencies

Zero Coupon Bonds

Powerball prizes awarded to the grand prize winner are payable in annual installments over 20 years. Prizes awarded to grand prize winners after November 2, 1997 are payable in annual installments over 25 years. The first payment is made by the Lottery within weeks of the drawing. Treasury zero coupon bonds that provide payments corresponding to the Lottery's obligation to these winners are purchased by the Multi-State Lottery (MUSL). MUSL holds these bonds in an account for the Lottery, cashes the bonds when due, and wires the money to the Lottery on or before the anniversary date of the winner. The investments and related prize liabilities for winners of these games are excluded from these financial statements.

Prior to 1998, the MUSL had purchased zero coupon bonds for the Lottery to fund future installment payments aggregating \$ 224,979,000. The total purchase price of these bonds was \$ 117,288,823. During fiscal year 2001, a cash out option was offered to these prize winners as a result of Congressional changes in the United States Internal Revenue Code of 1986, as amended, specifically Section 451(h). These cash out options were taken by six prize winners in the amount of approximately \$ 43,500,000. Total future installments outstanding at June 30, 2008 and 2007 are \$ 16,450,000 and \$ 20,302,000, respectively.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

5 - Contingencies (Continued)

MUSL Prize Reserves

The Lottery is a member of the MUSL, which consists of 29 state and district lotteries. MUSL operates the Powerball game, a semiweekly 5 out of 53 plus 1 out of 42 lotto game. The grand prize is determined on a parimutuel basis, payable over a set number of years. A cash option became available on November 2, 1997. The remaining prizes are set cash prizes. Each MUSL member sells Powerball tickets through its retailers and makes weekly wire transfers to the MUSL. The weekly transfer amount consists of 50 percent of weekly sales less actual set cash prizes paid by the Lottery. The prize pool for all Powerball prize categories consists of 50 percent of each drawing period's sales, until the grand prize is funded to the annuitized amount guaranteed by the MUSL. When the grand prize fund reaches the guaranteed annuitized amount, then 48 percent of sales becomes part of the prize pool and 2 percent of sales is placed in the prize reserve fund. The MUSL has placed a \$ 75,000,000 cap on the prize reserve account and a \$ 25,000,000 cap on the set prize reserve account. Once the prize reserve accounts exceed the designated caps, the excess will become part of the prize pool. The prize reserve account serves as a contingency reserve fund to protect the MUSL in case of unforeseen, but valid liabilities for grand prize claims or for set prizes.

The Powerball prize reserve and set prize reserve account monies are refundable to MUSL members if the MUSL disbands or if a member withdraws from MUSL. Members leaving MUSL must wait one year before receiving their refund. At June 30, 2008 and 2007, the prize reserve account had a balance of \$ 73,237,975 and \$ 69,701,252, respectively, of which the Lottery's contribution was \$ 1,363,439 and \$ 1,330,845, respectively. The set prize reserve at June 30, 2008 and 2007 had a balance of \$ 25,000,000 and \$ 24,779,750, respectively, of which the Lottery's contribution was \$ 462,125 and \$ 391,425, respectively.

The 2 by 2 prize reserve monies are refundable to MUSL members if the MUSL disbands or if a member withdraws from MUSL. Members leaving MUSL must wait one year before receiving their refund. At June 30, 2008 and 2007, the prize reserve account had a balance of \$ 280,972, of which the Lottery's contribution was \$ 122,318.



KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

5 - Contingencies (Continued)

MUSL Prize Reserves (Continued)

The Hot Lotto prize reserve monies are refundable to MUSL members if the MUSL disbands or if a member withdraws from MUSL. Members leaving MUSL must wait one year before receiving their refund. At June 30, 2008 and 2007, the prize reserve account had a balance of \$ 4,191,108 and \$ 3,543,064, respectively, of which the Lottery's contribution was \$ 563,106 and \$ 490,634, respectively.

The Lottery has contributed to an account with MUSL which is used to pay certain operating expenses incurred by member lotteries for the Powerball game. With certain restrictions, the balances in this account are refundable to the member lotteries upon termination of the member's agreement with MUSL or upon the disbanding of MUSL. At June 30, 2008 and 2007, the Lottery's portion of the balance of this account was \$ 901,198 and \$ 1,091,961, respectively, and is reported as a receivable.

Win for Life

The Lottery purchases annuity contracts from insurance companies in the name of the Win for Life game jackpot prize winners. In the event an insurance company defaults on its payments, the Kansas Life and Health Insurance Guarantee Association (KLHIGA) will make the payments. The KLHIGA was statutorily created, as set forth in K.S.A. 40-3008, subsection (o), to provide coverage in the event an insurance company defaults. The Lottery remains contingently liable for the payment of the lifetime prizes in the event the insurance companies and the KLHIGA fail to meet their obligation.

Annuity contracts have been purchased for lifetime prize payments. At June 30, 2008 and 2007, the approximate remaining prize payments are \$ 517,500 and \$ 535,500, respectively. Prize payments are due in varying amounts through September 2048 or the life of the individuals.

Litigation

There may, at times, be claims and/or lawsuits to which the Lottery is a party. The Lottery management and legal counsel anticipate that the potential claims against the Lottery would not materially affect the financial position of the Lottery.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

6 - Risk Management

The Lottery's risk management activities for workers' compensation and unemployment are recorded in the State Workers' Compensation Self-Insurance Fund and the Employment Security Fund, funds of the State of Kansas. The Lottery contributes to these funds based upon annual assessed rates.

Employees are offered various health insurance coverage programs of the State. The Lottery's contribution toward single member coverage ranges from 85 percent to 97 percent, based on salary level and tobacco usage of the employee.

State agencies are not allowed to purchase or carry insurance on any property owned by the State or its agencies, except as expressly and specifically authorized by statute. Currently, none of the exceptions apply to property of the Lottery. The State has had no problem in resolving losses in the past through utilization of resources available at the time the loss occurred. The Lottery retains liability for property and equipment damage.

Tort claims involving Lottery employees are subject to the Kansas Tort Claims Act (K.S.A. 75-6101, *et seq.*).

Employees' faithful performance is covered by commercial insurance. There has been no significant reduction in insurance coverage. Settlements have not exceeded insurance coverage in the past three years.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

7 - Payments to the State of Kansas

Pursuant to the Act, the Director of Accounts and Reports of the State of Kansas shall transfer monies in the Lottery operating fund to the State Gaming Revenue fund (the fund), at least monthly, in an amount equal to the monies in such fund in excess of those needed for payment of Lottery expenses, payment of compensation to retailers and transfers to the prize payment fund as certified by the Executive Director of the Lottery. For the years ended June 30, 2008 and 2007, the State Legislature set a minimum amount of transfers to the fund of \$ 72,040,000 and \$ 66,288,000, respectively. In addition, for the years ended June 30, 2008 and 2007, mandated transfers were made to the fund of \$ 880,163 and \$ 913,138, respectively, from proceeds of special veterans' games and mandated transfers of \$ 46,954 and \$ 16,098, respectively, were made to the State General Fund. Total transfers to the State of Kansas of \$ 70,046,954 and \$ 71,016,098 were made for the years ended June 30, 2008 and 2007, respectively, of which \$ 6,000,000 and \$ 5,750,000 were unpaid as of June 30, 2008 and 2007, respectively.

8 - Pension Plan

*Plan description.* The Lottery participates in the Kansas Public Employees Retirement System (KPERS), a cost-sharing, multiple-employer defined benefit pension plan as provided by K.S.A. 74-4901, *et seq.* KPERS provides retirement benefits, life insurance, disability income benefits, and death benefits. Kansas law establishes and amends benefit provisions. KPERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to KPERS (611 South Kansas Avenue, Suite 100; Topeka, Kansas 66603-3803) or by calling 1-800-228-0366.

*Funding policy.* K.S.A. 74-4919 establishes the KPERS member-employee contribution rate at four percent of covered salary. Eligible employees are considered full-time with one year of service. The employer collects and remits member-employee contributions according to the provisions of Section 414(h) of the Internal Revenue Code. State law provides that the employer contribution rate be determined annually based on the results of an annual actuarial valuation. KPERS is funded on an actuarial reserve basis. State law sets a limitation on annual increases in the contribution rates for KPERS employers. The employer rates established by statute for calendar years 2008 and 2007 are 6.37 and 5.77 percent, respectively. The Lottery contributions to KPERS for the years ending June 30, 2008, 2007 and 2006, were approximately \$ 260,000, \$ 223,000, and \$ 203,000, respectively, equal to 100% of the statutorily required contributions for each year.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

9 - Operating Segment Information

Operating segment information by game is as follows:

Year Ended June 30, 2008											
	Instant	Pull Tabs	Power- ball	2 by 2	Kansas Cash	Keno	eScratch	Pick 3	Hot Lotto	Kansas Hold 'Em	Total
Sales, net	\$ 115,068,384	\$ 7,593,607	\$ 42,919,790	\$ 1,652,834	\$ 17,428,827	\$ 31,274,217	\$ 1,048,865	\$ 5,814,236	\$ 9,225,833	\$ 4,640,878	\$ 236,667,471
Prizes, net	(68,587,829)	(4,246,051)	(21,773,787)	(839,910)	(8,764,851)	(17,604,066)	(705,775)	(2,923,944)	(4,679,878)	(2,844,366)	(132,970,457)
Retailer commissions	(6,439,297)	(422,141)	(2,353,581)	(101,862)	(1,179,498)	(2,010,022)	(138,946)	(335,438)	(671,358)	(116,540)	(13,768,683)
Gross margin	\$ 40,041,258	\$ 2,925,415	\$ 18,792,422	\$ 711,062	\$ 7,484,478	\$ 11,660,129	\$ 204,144	\$ 2,554,854	\$ 3,874,597	\$ 1,679,972	\$ 89,928,331

Year Ended June 30, 2007											
	Instant	Pull Tabs	Power- ball	2 by 2	Kansas Cash	Keno	eScratch	Pick 3	Hot Lotto	Kansas Hold 'Em	Total
Sales, net	\$ 114,674,052	\$ 9,382,750	\$ 39,322,778	\$ 1,717,945	\$ 20,053,110	\$ 33,643,621	\$ 2,370,267	\$ 5,626,413	\$ 11,461,422	\$ 1,702,686	\$ 239,955,044
Prizes, net	(69,814,318)	(5,712,280)	(18,840,357)	(841,793)	(9,676,024)	(18,413,691)	(1,564,376)	(2,756,942)	(5,566,097)	(1,021,612)	(134,207,490)
Retailer commissions	(6,986,649)	(571,655)	(2,149,464)	(94,315)	(1,099,916)	(1,867,221)	(134,157)	(308,890)	(629,232)	(95,350)	(13,936,849)
Gross margin	\$ 37,873,085	\$ 3,098,815	\$ 18,332,957	\$ 781,837	\$ 9,277,170	\$ 13,362,709	\$ 671,734	\$ 2,560,581	\$ 5,266,093	\$ 585,724	\$ 91,810,705

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

10 - Budget and Actual Comparison

As discussed in Note 1, the Lottery prepares an annual budget of expenses on a cash plus encumbrance basis. The operating and cost of sales (COS) expenses are currently on a no-limit basis, with the exception of Kansas Incentive Program (KSIP) and official hospitality line items.

The operating fund currently has a no-limit appropriation. The no-limit allows the budget to be prepared to reflect the operating and COS requirements of increasing sales and doing business as a lottery. The prize fund has had a no-limit appropriation for several years allowing the flexibility needed for paying winners' claims. Each year the current year budget is revised and the next year's budget is prepared. The completed budget document is submitted to the Department of Budget, and must have the approval of the Governor and Legislature.

At June 30, 2008, there were only two separate line items budgeted: KSIP appropriations and official hospitality for the year ended June 30, 2008 actual expenses on a budgetary basis were \$ 138,022 for KSIP appropriations out of the budgeted amount of \$ 472,588 and actual expenses on a budgetary basis for official hospitality were \$ 2,593 out of the budgeted amount of \$ 5,000.

11 - Other Postemployment Healthcare Benefits

*Description.* Kansas statute provides that postemployment healthcare benefits be extended to retired employees who have met age and/or service eligibility requirements. The health insurance benefit generally provides the same coverage for retirees and their dependants as for active employees and their dependents. The health insurance benefit plan is a single employer defined benefit plan administered by Kansas Health Policy Authority. The benefit is available for selection at retirement and is extended to retirees and their dependents for life. Non-Medicare participants are subsidized by the State, thus resulting in a liability to the State. The accounting for the health insurance for retirees is included in the State's Self-Insurance Health fund, with the subsidy provided from the Self-Insurance Health fund.

*Funding Policy.* The State provides health insurance benefits to retirees and their dependents in accordance with Kansas law (K.S.A. 75-6511). Kansas statute, which may be amended by the state legislature, established that participating retirees contribute to the employee group health fund benefits plan, including administrative costs.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

11 - Other Postemployment Healthcare Benefits (Continued)

The State appropriates funds annually for the costs associated with this retirement benefit and provides funding for the expenditure on a pay-as-you-go basis through the Self Insurance Fund. In fiscal year 2008, non-Medicare retired plan members receiving benefits contributed \$14,541,101 to the plan and the State contributed \$5,104,755 to the plan.

Annual OPEB Cost and Net OPEB Obligation. The State's annual OPEB (Other Post Employment Benefits) cost is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period of not to exceed thirty years. The following table presents the components of the State's annual OPEB cost for the year, the contributions to the plan, and changes in the State's net OPEB obligation.

Annual required contribution-amortized liability	\$ 16,040,000
Interest on amortized liability	617,000
Normal cost (with interest)	17,195,000
Annual OPEB cost (expense)	<u>33,852,000</u>
Contributions made	<u>(5,105,000)</u>
Increase in net OPEB obligation	28,747,000
Net OPEB obligation July 1, 2007	-
Net OPEB obligation June 30, 2008	<u><u>\$ 28,747,000</u></u>

The Lottery's share of the State's net OPEB obligation at June 30, 2008 was \$ 80,037.

**Schedule of Employer Contributions (for fiscal year ended)**

	Fiscal	Annual	Net	Percentage	End of
	Year	OPEB	Employer	Contributed	Year
		Cost	Contributions		Net OPEB
					Obligation
State of Kansas	2008	\$ 33,852,000	\$ 5,105,000	15.08%	\$ 28,747,000
Kansas Lottery	2008	80,037	-	-	80,037

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

11 - Other Postemployment Healthcare Benefits (Continued)

*Funded Status and Funding Progress.* As of June 30, 2008, the most recent actuarial valuation date, the actuarial accrued liability for benefits was \$316,640,000. The State's policy is to fund the benefits on a pay as you go basis, resulting in an unfunded actuarial accrued liability (UAAL) of \$316,640,000. The covered payroll (annual payroll of active employees covered by the plan) was \$1,969,392,000, and the ratio of the UAAL to the covered payroll was 16.08 percent.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. The valuation includes, for example, assumptions about future employment, mortality and the healthcare cost trends. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with the past expectations and new estimates are made about the future. The schedule of funding progress will present in time, multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing relative to the actuarial accrued liabilities for benefits.

**Schedule of Funding Progress**

	Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percent of Covered Payroll (b-a)(c)
State of Kansas	6/30/2008	\$ -	\$ 316,640,000	\$ 316,640,000	0%	\$ 1,969,392,000	16.08%
Kansas Lottery	6/30/2008	\$ -	\$ 727,666	\$ 727,666	0%	\$ 3,767,344	19%

The Lottery's Actuarial Accrued Liability is included in accounts payable and accrued liabilities on the balance sheet at June 30, 2008.

*Actuarial Methods and Assumptions.* Projections of benefits for reporting purposes are based on the substantive plan and include the types of benefits provided at the time of valuation and the historical pattern of sharing of benefit cost between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and actuarial value of assets, consistent with the long-term perspective of the calculations.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)

NOTES TO FINANCIAL STATEMENTS  
(Continued)

11 - Other Postemployment Healthcare Benefits (Continued)

In the June 30, 2008 actuarial valuation, the projected unit credit method was applied. The actuarial assumptions included a 3.85 percent investment rate of return, which is a blended rate of the expected long-term investment returns on the State's pooled funds and investments. The valuation assumed annual healthcare cost trend rates of 5.5 to 10 percent in the first ten years and an ultimate rate of 5.0 percent after ten years. The valuation followed generally accepted actuarial methods and included tests as considered necessary to assure the accuracy of the results. The UAAL is being amortized over a 30 year open period in level dollar amounts.

12 - Privilege Fees

The Lottery assesses a privilege fee on applicants who would like to be considered as a potential expanded gaming facility manager. The privilege fee acts as a deposit showing the management company's interest in managing one of the four gaming facilities throughout the State of Kansas. Privilege fees assessed are \$ 25,000,000 per applicant for the southeast, south-central and northeast regions and \$ 5,500,000 per applicant for the southwest region. If an applicant is not awarded the contract for the region, the privilege fee is reimbursed in full. These fees are accounted for in the agency fund.



**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON  
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL  
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING  
STANDARDS**

Legislative Post Audit Committee  
Kansas State Legislature:

We have audited the basic financial statements of the business-type activity and the aggregate remaining fund information of the Kansas Lottery (the Lottery), a component unit of the State of Kansas, as of and for the year ended June 30, 2008, and have issued our report thereon dated November 13, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Lottery's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying schedule of findings and responses to be a significant deficiency in internal control over financial reporting. The significant deficiency is listed as item 2008-1.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Lottery's response to the significant deficiency identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the Lottery's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management and the Legislative Post Audit Committee of the Kansas State Legislature and is not intended to be and should not be used by anyone other than those specified parties.

*Allen, Gibbs & Houlik, L.L.C.*

*Berberich Trahan & Co., P.A.*

November 13, 2008

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)  
SCHEDULE OF FINDINGS AND RESPONSES

Year Ended June 30, 2008

**Finding 2008-1 – Significant Deficiency**

*Condition* – During the course of our audit, we identified adjustments to the trial balance that were not initially identified by the Lottery's internal control structure. This finding is repeated from the prior year.

*Criteria* – The financial statements are the responsibility of management. As such, the Lottery's internal control over the financial statements should identify misstatements on a consistent basis.

*Cause* – Inappropriate application of generally accepted accounting principles.

*Effect* – The financial statements prepared by the Lottery may be materially misstated.

*Recommendation* – We recommend that the Lottery review its trial balance at year-end to ensure that all adjustments have been made.

*Management's Response (Unaudited)* – The finance department will continue to improve the internal controls in the reconciliation of the year-end entries. We are completing final reconciliations and entries as the auditors arrive, and we will strive to have the work completed before the beginning of the audit in the future.

KANSAS LOTTERY  
(A COMPONENT UNIT OF THE STATE OF KANSAS)  
PRIOR YEAR FINDINGS AND RESPONSES

Year Ended June 30, 2008

**Finding 2007-1 – Significant Deficiency**

*Condition* – During the course of our audit, we identified adjustments to the trial balance that were not initially identified by the Lottery's internal control structure. This finding is repeated from the prior year.

*Criteria* – The financial statements are the responsibility of management. As such, the Lottery's internal control over the financial statements should identify misstatements on a consistent basis.

*Cause* – Inappropriate application of generally accepted accounting principles.

*Effect* – There is the potential that the financial statements may be materially misstated.

*Recommendation* – We recommend that the Lottery review its trial balance at year-end to ensure that all adjustments have been made.

*Management's Response (Unaudited)* – The finance department will increase their internal control in the reconciliation of the documentation and worksheets used during the estimation of the accruals used in the preparation of the financial statements. Internal control will be increased by having the data entries in the spreadsheets compared to the original data reports. This will ensure that the adjustments have been correctly made.

Follow-up: Based on significant journal entries made during the audit in the current year, this finding has not been resolved and has been repeated as Finding 2008-1 significant journal entries were made during the audit.



Ed Van Petten  
Executive Director

Kathleen Sebelius  
Governor

November 13, 2008

Ms. Karen L. Linn, CPA  
Shareholder  
Berberich Trahan & Co., P.A.  
3630 SW Burlingame Road  
Topeka, KS 66611-2050

Dear Ms. Linn:

We have reviewed your draft of the Financial and Compliance Audit Report for the Kansas Lottery for the fiscal year ended June 30, 2008 and we concur with the results of the audit.

We offer the following response to the one finding citing account reconciliations in our fiscal year 2008 audit. The finance department will continue to improve the internal control in the reconciliation of the year end entries. We are completing final reconciliations and entries as the auditors arrive, and we will strive to have the work completed before their arrival in the future.

As in the past, we certainly appreciate the professional manner in which you and your staff worked with our staff in the audit preparation.

Sincerely,

Ed Van Petten  
Executive Director

